TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
August 14, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED JUNE 30, 2001

Commission File Number: 0001003986

CALVIN B. TAYLOR BANKSHARES, INC.

I.R.S. Employer Identification No.: 52-1948274
State of incorporation: Maryland

Address of principal executive offices: 24 North Main Street, Berlin, Maryland 21811
Issuer's telephone number: (410) 641-1700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: The registrant had 3,240,000 shares of common stock ($1.00 par) outstanding as of July 31, 2001.

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Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Notes to Financial Statements

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been made. These adjustments are of a normal recurring nature. Results of operations for the six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. For further information, refer to the audited consolidated financial statements and related footnotes for the Registrant's fiscal period ended December 31, 2000.

Consolidation has resulted in the elimination of all significant intercompany accounts and transactions.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and overnight investments in federal funds sold.

Per share data

Earnings per common share and dividends per common share are determined by dividing net income and dividends by the 3,240,000 shares outstanding, giving retroactive effect to stock dividends distributed.

2. Comprehensive Income

Comprehensive income consists of:

	Six months ended June 30, 2001	Six months ended June 30, 2000
Net income	$2,848,348	$2,602,452
Unrealized gain (loss) on investment securities available for sale, net of income taxes	(35,381)	70,935
Comprehensive income	$2,812,967	$2,673,387

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part I - Financial Information
Consolidated Statements of Condition

	(unaudited) 30-Jun 2001	31-Dec 2000

Assets		
Cash and due from banks	14,889,325	13,332,279
Federal funds sold	42,094,877	18,167,527
Interest-bearing deposits	784,000	784,000
Investment securities available for sale	3,634,477	4,052,934
Investment securities held to maturity (approximate fair value of $62,083,983 and $76,610,933)	61,617,466	76,273,558
Loans, less allowance for credit losses of $2,187,275 and $2,192,755	171,583,770	168,571,199
Premises and equipment	5,797,841	5,620,478
Accrued interest income	2,074,681	1,948,199
Deferred income taxes	129,489	107,227
Other assets	194,132	190,610
	302,800,058	289,048,011
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	55,713,537	49,674,943
Interest-bearing	186,032,708	182,251,249
	241,746,245	231,926,192
Securities sold under agreements to repurchase	4,266,689	3,113,671
Accrued interest payable	521,343	503,519
Note payable	223,728	231,517
Accrued income taxes	138,508	103,818
Other liabilities	5,369	84,085
	246,901,882	235,962,802
Stockholders' equity		
Common stock, par value $1 per share authorized 10,000,000 shares, issued and issued and outstanding 3,240,000 shrs	3,240,000	3,240,000
Additional paid in capital	17,290,000	17,290,000
Retained earnings	34,906,846	32,058,498
	55,436,846	52,588,498
Net unrealized gain on securities available for sale	461,330	496,711
	55,898,176	53,085,209
	302,800,058	289,048,011

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	For the three months ended June 30,	
	2001	2000
Interest and dividend revenue		
Loans, including fees	3,622,418	3,386,255
U.S. Treasury and Agency securities	798,692	799,047
State and municipal securities	92,535	96,356
Federal funds sold	351,967	380,430
Deposits with banks	12,076	10,402
Equity securities	4,769	5,708
Total interest and dividend revenue	4,882,457	4,678,198
Interest expense		
Deposit interest	1,526,482	1,397,301
Other	15,801	3,605
Total interest expense	1,542,283	1,400,906
Net interest income	3,340,174	3,277,292

Provision for credit losses	-	41,000
Net interest income after provision for credit losses	3,340,174	3,236,292
Other operating revenue		
Service charges on deposit accounts	206,734	187,640
Miscellaneous revenue	160,814	124,447
Total other operating revenue	367,548	312,087
Other expenses		
Salaries and employee benefits	810,247	818,945
Occupancy	76,655	140,310
Furniture and equipment	147,687	93,701
Other operating	399,662	484,173
Total other expenses	1,434,251	1,537,129
Income before income taxes	2,273,471	2,011,250
Income taxes	781,979	704,925
Net income	1,491,492	1,306,325
Basic earnings per share	0.46	0.40

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	For the six months ended June 30, 2001	2000
Interest and dividend revenue		
Loans, including fees	7,198,542	6,650,015
U.S. Treasury and Agency securities	1,695,103	1,752,879
State and municipal securities	186,948	202,662
Federal funds sold	613,251	680,937
Deposits with banks	24,048	22,338
Equity securities	19,472	14,815
Total interest and dividend revenue	9,737,364	9,323,646
Interest expense		
Deposit interest	3,039,738	2,825,493
Other	31,844	8,497
Total interest expense	3,071,582	2,833,990
Net interest income	6,665,782	6,489,656
Provision for credit losses	-	83,080
Net interest income after provision for credit losses	6,665,782	6,406,576
Other operating revenue		
Service charges on deposit accounts	409,121	362,073
Miscellaneous revenue	243,327	193,409
Total other operating revenue	652,448	555,482
Other expenses		
Salaries and employee benefits	1,652,394	1,543,568
Occupancy	204,687	310,622
Furniture and equipment	290,157	330,549
Other operating	812,232	794,053
Total other expenses	2,959,470	2,978,792

Income before income taxes	4,358,760	3,983,266
Income taxes	1,510,412	1,380,814
Net income	2,848,348	2,602,452
Basic earnings per share	0.88	0.80

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

	For the six months ended June 30, 2001	2000
Cash flows from operating activities		
Interest received	9,575,982	9,322,123
Fees and commissions received	691,617	572,728
Interest paid	-3,053,758	-2,848,913
Cash paid to suppliers and employees	-2,837,651	-2,735,723
Income taxes paid	-1,475,723	-1,437,305
	2,900,467	2,872,910
Cash flows from investing activities		
Proceeds from maturities of investment securities	32,185,000	31,115,000
Purchase of investment securities held to maturity	-17,133,193	-10,363,137
Certificates of deposit purchased, net of redemptions	-	199,000
Purchases of premises, equipment, and intangibles	-437,589	-340,108
Loans made, net of principal collected	-3,012,571	-13,371,369
Proceeds from sales of equipment	17,000	423
	11,618,647	7,239,809
Cash flows from financing activities		
Net change in time deposits	5,158,643	-2,686,390
Net change in other deposits	4,661,410	-4,640,937
Net change in repurchase agreements	1,153,018	-
Payment on mortgage obligation	-7,789	-12,169
Dividend paid	-	-
	10,965,282	-7,339,496
Net increase (decrease) in cash	25,484,396	2,773,223
Cash and equivalents at beg of period	31,499,806	34,423,959
Cash and equivalents at end of period	56,984,202	37,197,182
Reconciliation of net income to net cash provided from operating activities		
Net income	2,848,348	2,602,452
Adjustments		
Depreciation and amortization	241,113	239,725
Deferred income tax	-	-
Provision for loan losses	-	83,080
Security discount accretion, net of premium amortization	-34,900	16,233
(Gain) loss on disposition of assets	-13,932	-
Decrease (increase) in accrued interest receivable and other assets	-113,960	-510
Increase (decrease) in accrued interest payable and other liabilities	-26,202	-68,070
	2,900,467	2,872,910

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part I. Financial Information
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements within the meaning of and made pursuant to the safe harbor provisions of the Private Litigation Securities Reform Act of 1995.

The following discussion of the financial condition and results of operations of the Registrant (the Company) should be read in conjunction with the Company's financial statements and related notes and other statistical information included elsewhere herein.

General

Calvin B. Taylor Bankshares, Inc. (the "Company") was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of two banks. Calvin B. Taylor Banking Company (the "Maryland bank") is a commercial bank that was established in 1890 and incorporated under the laws of the State of Maryland on December 17, 1907. This bank operates nine banking offices in Worcester County with the Bank's main office located in Berlin, Maryland. It is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Worcester County, Maryland and neighboring counties.

Calvin B. Taylor Bank of Delaware (the "Delaware bank") was incorporated in the state of Delaware in 1997. This one-branch Delaware bank, which offers the same services as the Maryland bank, opened late in the second quarter 1998. The Company currently engages in no business other than owning and managing the Banks.

Financial Condition

Total assets of the Company increased $13.8 million from December 31, 2000 to June 30 2001. Combined deposits and customer repurchase agreements increased $11.0 million during the same period. During the first quarter of the year, the banks typically experience a decline in deposits since business customers are using their deposits to meet cash flow needs. Generally, this situation reverses late in the second quarter of the year as the banks receive loan repayments from seasonal business customers, and deposits from summer residents and tourists. Management believes that adverse conditions in the stock markets may also have contributed to increased deposits in the banks during the first half of 2001.

During the first six months of 2001, the banks' loan portfolios have increased $3.0 million. Funding for these loans was provided by maturities of investment securities. Management expects increased earnings from this shift since loan yields are higher than investment yields. Management has determined that this shift would not negatively impact the Company's ability to meet liquidity demands.

The allowance for credit losses represents a reserve for potential loss in the loan portfolio. The adequacy of the allowance for credit losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on non-accruing, past due, and other loans that management believes require attention. The determination of the reserve level rests upon management's judgment about factors affecting loan quality and anticipated changes in the composition and size of the portfolio, as well as assumptions about the economy. Historically, the Company has low loan charge-offs. The banks' target levels for their allowances as a percentage of gross loans range from approximately 1.00% to 1.35%. Based on review of the consolidated loan portfolio, the Company determined than an allowance of 1.26% of gross loans was adequate as of June 30, 2001. At December 31, 2000, the allowance was 1.28% of gross loans. At June 30, 2001, one loan of $175,000 was nonaccruing, representing .10% of the portfolio, and $95,157 or .05% of the portfolio was delinquent ninety days or more.

Liquidity

The company's major sources of liquidity arise from loan repayments, short-term investments, including federal funds sold, and an increase in core deposits. Throughout the first quarter of the year, when the banks typically experience a decline in deposits, federal funds sold and investment securities are primary sources of liquidity. During the second quarter of the year, additional sources of liquidity become more readily available as business borrowers start repaying loans, and the banks receive seasonal deposits. Throughout the second and third quarters the banks maintain a high liquidity level. Funds from seasonal deposits are generally invested in short-term U.S. Treasury Bills and overnight federal funds. Average liquid assets (cash and amounts due from banks, interest bearing deposits in other banks, federal funds sold, and investment securities) compared to average deposits were 48.05% for the second quarter of 2001 compared to 46.21% for the first quarter of 2001 and 47.53% for the second quarter of 2000.

Results of Operations

Net income for the three months ended June 30, 2001, was $1,491,492 or $.46 per share, compared to $1,306,325 or $.40 per share for the second quarter of 2000. This represents an increase of $185,167 or 14.17% from the prior year. Year to date net income increased $245,896 or $.08 per share from $2,602,452 or $.80 per share in 2000 to $2,848,348 or$.88 per share in 2001. Significant reasons for the year to date increase in net income are an increase in net interest income, reduction of the provision for credit losses, and increased other revenues.

Net interest income increased $176,126 in the first six months of 2001 as compared to the first six months of 2000. This increase is attributable to the shift from investment securities to higher earning loans, and to increased levels of federal funds sold. The Company's net interest income is one of the most important factors in evaluating its financial performance. Management uses interest sensitivity analysis to determine the effect of rate changes. Net interest income is projected over a one-year period to determine the effect of an increase or decrease in the prime rate of 100 basis points. If prime were to decrease one hundred basis points and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience a decrease of less than six percent in net interest income. The sensitivity analysis does not consider the likelihood of these rate changes nor whether management's reaction to this rate change would be to reprice its loans or deposits.

No provision for loan losses was made in the first half of 2001, versus an $83,080 provision in first half of 2000. Net charge-offs during the second quarter of 2001, and the year-to-date, were $5,480.

Personnel expenses are higher for the six months ended June 30, 2001 compared to the same period in 2000 due to general increases in salaries and the addition of two new positions. The banks employed 106 full time equivalent employees as of June 30, 2001, an increase of three employees from June 30, 2000. The Maryland bank hires seasonal employees during the summer. The Company has no employees other than those hired by the banks.

The Company's occupancy expense decreased $106 thousand from first half 2000 to 2001. Of this, $39 thousand was due to the relocation in 2000, of vehicular access to a branch, which was necessary due to road construction. Also in 2000, the Maryland bank consolidated two branches in Pocomoke Maryland, and incurred cost to move and otherwise disposed of assets from the abandoned branch. In the same six month period, furniture and equipment expense decreased by $40 thousand due to lower service contract costs and a change in accounting for service contracts from cash basis to amortizing the cost through out the year. Although the Company's current data processing equipment meets the needs of the banks, it is nearing the end of its economic life. The Company expects to replace its core processing system in the fourth quarter of 2001 and expects related depreciation, maintenance costs, and software amortization expense to increase with this replacement. Prior to the installation of the new processing system, improved data storage, networking, and Internet banking systems are planned. It is anticipated that these, too, will cause an increase in related costs.

Plans of Operation

The banks conduct general commercial banking businesses in their service areas, of Worcester County, Maryland and Sussex County, Delaware, while also emphasizing the banking needs of individuals and small- to medium-sized businesses and professional concerns. The banks offer a full range of federally insured deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts and other time deposits of various types ranging from daily money market accounts to longer-term certificates of deposit.

The Company, through its banks, offers a full range of short- to medium-term commercial and personal loans, and originates mortgage loans, including real estate construction and acquisition loans. The banks have the intent and the ability to hold loans that their portfolios.

Other bank services include cash management services, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, debit cards, and automatic drafts for various accounts. The Company is associated with the MAC network of automated teller machines that may be used by customers throughout Maryland, Delaware and other regions. The Company offers credit card services through a correspondent bank.

Capital Resources and Adequacy

Total stockholders' equity increased $2,812,967 from December 31, 2000 to June 30, 2001. This increase is attributable to the comprehensive income recorded during the period, as detailed in

Note 2 of the Notes to Financial Statements.

Under the capital guidelines of the Federal Reserve Board and the FDIC, the Company and its banks are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common shareholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. In addition, the Company and the banks must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 3%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

Tier one risk-based capital ratios of the Company as of June 30, 2001 and 2000 were 35.80% and 35.41%, respectively. Both are substantially in excess of regulatory minimum requirements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's principal market risk exposure relates to interest rates on interest-earning assets and interest-bearing liabilities. Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the banks are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management monitors and seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

At June 30, 2001, the Company's interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 26.52%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. Both banks have classified their demand mortgage and commercial loans as immediately repricing. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans and change the rates rests with management.

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part II. Other Information

Item 1 Legal Proceedings
Not applicable

Item 2 Changes in Securities and Use of Proceeds
Not applicable

Item 3 Defaults Upon Senior Securities
Not applicable

Item 4 Submission of Matters to a Vote of Security Holders

The Company held its annual meeting on May 2, 2001, during which the items detailed in the proxy statement dated March 7, 2001, were approved. This includes the reelection of the Board of Directors.

Item 5 Other information

Not applicable.

Item 6 Exhibits and Reports on Form 8-K

a) Exhibits

2. Proxy Statement dated March 7, 2001, is incorporated by reference.

b) Reports on Form 8-K

There were no reports on Form 8-K filed for the quarter ended June 30, 2001.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Calvin B. Taylor Bankshares, Inc.

Date: __________________ By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.
President and Chief Executive Officer

Date: __________________ By: /s/ William H. Mitchell
William H. Mitchell
Chief Financial Officer